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U. S. DEPARTMENT OF AGRICULTURE

Chainstore Merchandising and Procurement Practices

The Changing Retail Market for Fresh Fruits and Vegetables

MARKETING RESEARCH REPORT NO. 417

U. S. DEPARTMENT OF AGRICULTURE
AGRICULTURAL MARKETING SERVICE
MARKETING ECONOMICS RESEARCH DIVISION

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Washington, D. C. July 1960

HIGHLIGHTS

Food retailing has experienced a revolution in the last 30 years. It has changed from a system dominated by the small corner grocery store to one dominated by huge supermarkets. The supermarkets are increasingly controlled by large organizations--both chains and voluntary and cooperative groups--with centralized procurement and merchandising policies. These groups controlled about 72 percent of the food sold through retail stores in 1958.

There is vigorous competition between the chains in each market. Each organization strives to improve its own position by a combination of the various elements of competition calculated to win itself a larger number of regular customers and an increased share of the business. Fresh fruits and vegetables are a key item in merchandising policy. They are used as "traffic builders" by almost all chains. Some emphasize quality at any cost. Others attempt to maximize quality at a more modest price level. In every case, procurement policy and practices are designed to supply the quality and price level needed to fit the organization's merchandising policies.

Both corporate and voluntary chains have moved increasingly into direct buying of fresh fruits and vegetables from the shipping point during the 1950's. Some organizations feel that their buying prices, on the average, are lower when they buy direct than when they buy on terminal markets. Others made the shift primarily to obtain advance assurance of supplies and prices which enable them to plan their merchandising programs. Many feel that both reasons are important.

Direct buying has increased sharply during the 1950's because the number of organizations large enough to buy economically from the shipping point has grown in that period. It will probably continue to increase for some time as additional chains grow--either through internal growth or merger--to a size which makes direct buying attractive to them.

There is probably a fairly effective limit on the growth of direct buying, at about 50 to 60 percent of the total volume. The limit is set by (1) the needs of the institutional trade and of unaffiliated grocery stores which are almost entirely supplied by the wholesale trade and (2) by the need of chains buying direct to obtain fill-ins and specialty items from the local markets. Direct buying may not actually reach the suggested upper limit.

The share of the total supply passing through the traditional wholesale market will decline if direct buying increases further. Wholesale firms will find it necessary to make adjustments to the changing situation, taking on different functions and developing other lines of business. Growers and shippers also will find it necessary to make adjustments. There will be fewer buyers, each dealing in larger and more uniform lots. "Orderly marketing" will be increasingly important, since it will be more difficult to find market outlets at remunerative prices for off-grade produce and temporary surpluses.

With a smaller number of buyers for a given supply, the effect of the actions of each buyer upon prices becomes more pronounced. It may therefore be presumed that the growth of direct buying has been accompanied by less stability of prices, contrary to stated objectives of chainstore buyers.

CHAINSTORE MERCHANDISING AND PROCUREMENT PRACTICES

The Changing Retail Market for Fresh Fruits and Vegetables

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BACKGROUND OF THE STUDY

In 1935, 354,000 grocery stores sold $7.8 billion of food. In 1958, 285,000 grocery stores sold $44.1 billion of food. The number of stores had declined 20 percent and average sales per store had increased nearly sixfold. The supermarket had taken over most of food retailing.

During this period, the supermarket changed from an isolated venture of a few pioneers to the accepted method of food retailing. Grocery chains, which in the twenties and early thirties consisted largely of small, corner stores selling mostly dry groceries with limited lines of fresh meat and other perishables, had become organizations of supermarkets selling 5,000 or more different items, including extensive selections of fresh meats, fruits and vegetables, and other perishable lines.

These changes brought major repercussions throughout the food industry. This study briefly describes some of the changes which have taken place in the structure of food retailing--characterized by the rise of the supermarket--and analyzes and evaluates the effects on the fresh fruit and vegetable industry. The policies and practices of chain supermarket organizations in promoting and selling fresh fruits and vegetables, the effects of these policies on procurement methods, and their impacts on production and marketing methods are described and analyzed.

The goal of this study is to assist producers and marketers of fresh fruits and vegetables to understand better the marketing system with which they are dealing. The marketing system is constantly changing, and in recent years both the direction and rate of change have shifted. An awareness of these developments is essential in order for producers and marketers to be able to plan for the future in the most productive manner.

1/ This study was conducted and the first draft of this report written by Dr. Folz, who is head of the department of agricultural economics at the University of Idaho, while he was on leave from the university and employed by the Agricultural Marketing Service. The final report was prepared for publication by Dr. Manchester.

Procedure

Produce merchandising or buying officers of 12 large chainstore organizations and 4 smaller chains were interviewed. One or another of the 12 large chains has stores in every mainland State in the Union. The sales of these 12 chains accounted for 28 percent of all food store sales in 1957.

The discussion with each of these companies covered five broad areas of the chain's policies and practices in the purchase and sale of fresh fruits and vegetables: (1) Promotional policy and selling practices for fresh fruits and vegetables and their place in the competitive strategy of the concern; (2) quality requirements for fresh fruits and vegetables and the procedure followed in attempting to assure the desired quality; (3) methods of buying and sources of supply; (4) the degree to which the organization employed formal or informal arrangements with suppliers, tending to lead to vertical integration; and (5) the methods used in arriving at the purchase price, the point at which the price was determined, and the procedure followed to assure the company the "best" price.

The information which provided the basis for this report was obtained in these interviews. It was largely of a qualitative nature, dealing with policies and practices rather than with specific quantities. It has been checked where possible against other materials, but this was generally not possible.

THE CHANGING STRUCTURE OF FOOD RETAILING

The present retail food marketing system developed through several different stages. In the first three decades of the twentieth century, the chainstore systems--several of them founded between 1859 and the turn of the century--developed into a major force in grocery distribution. By 1929, chains with four or more stores were doing slightly more than one-fourth of the food store business, including the substantial business done by specialty food stores (meat markets, fruit and vegetable stores, etc.) but excluding a significant volume of business still done by country general stores. The typical chainstore of the twenties was small, stocked a limited number of fast-moving grocery items and more limited lines of perishables or perhaps none, and served a fairly limited area on a cash-and-carry basis, when "cash and carry" meant that in a literal sense for a majority of the customers. The chainstores of that period built their success on a low-price policy, made possible by the elimination of services such as credit and delivery and the economies of mass procurement and warehousing.

The "hard money" years of the depression created a fertile field for the food retailer who could feature even lower prices. But the chainstores had already exploited the economies of mass procurement and elimination of services. Into this fertile field came the early supermarkets, cutting costs and prices even further through the economies of mass distribution. Some of the early enterprises even eliminated display racks, piling cases of canned goods and other groceries on the floor of bankrupt auto display rooms or warehouses.

The "cheapie" supermarkets, as some of the early ones were called, appealed to the mood of the depression, but the late thirties and early forties brought better times, and supermarkets changed with the times. They became attractive places in which to shop, with more of the amenities, while retaining the advantages of mass distribution. The chains, some of which were at first reluctant to convert to supermarkets, became convinced that the road to prosperity led--and the pressures of competition compelled--in this direction, and they began to close small stores and open supermarkets.

By the time the 1939 census was taken, chains with four or more stores operated 82 percent of the supermarkets, compared to 52 percent in 1935--taking the then-current definition of a supermarket as a store with sales of at least $300,000 per year. Both chains and independents continued to shift to supermarkets until World War II brought a virtual halt to the construction of new stores, except in areas which had no other retail facilities or grossly inadequate ones.

After the war, the conversion shifted into high gear. With only a brief pause during the Korean conflict, the supermarket share of food sales leaped upward year after year until it is now estimated at 64 percent of total grocery store sales (fig. 1).

During the postwar period, the voluntary and cooperative groups of retailers, whose history dated back nearly as far as that of the chains, also began a vigorous growth as their members shifted into supermarket operations. New groups were formed, in some cases consisting entirely of independent supermarkets or small supermarket chains. Through centralized procurement and warehousing, the independents and the small chains were able to gain many of the economies which the larger chains possessed. By 1958, a major trade publication estimated that 73 percent of sales of independent grocery stores (single units and "chains" with 10 stores or less) were made by stores affiliated with voluntary or cooperative groups, although many of their supplies were not actually bought through these groups.

Food Retailing in the 1950's

The supermarket had become the dominant force in food retailing by the opening of the decade of the fifties. The issues were no longer supermarket vs. small store but the size and kind of organization which would operate the supermarkets.

Six major groups contend for the retail food market of today, including at least three types of corporate chains:

(1) The three national chains, with stores in 21 to 37 States each and with sales of over $1 billion per chain in 1958;

(2) The regional chains, each with several operating divisions, usually in several States, and most with 1958 sales of $100 million or more;

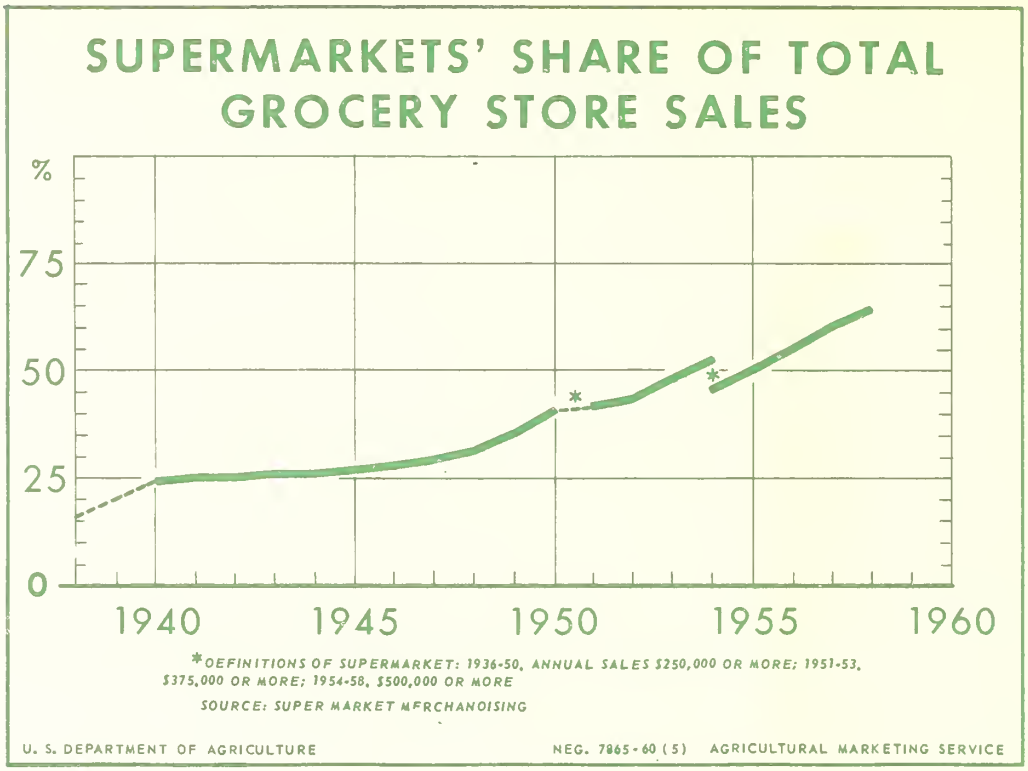

Figure 1

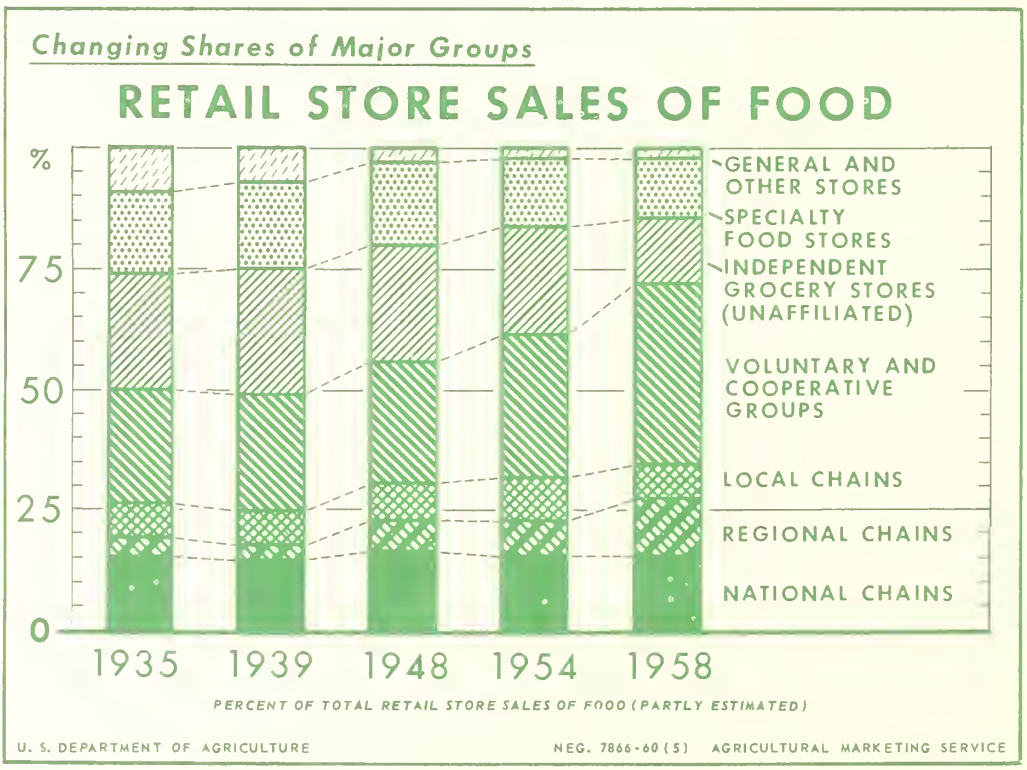

Figure 2

(3) The local chains, usually with only one operating division, generally operating in only one State, with 1958 sales ranging from a few million to over $100 million per chain.

Generally speaking, these chains are composed wholly of supermarkets or they are converting their remaining smaller stores to supermarkets as rapidly as possible. Then there are the affiliated groups:

(4) Retailer-cooperatives--at least 15 groups with annual retail sales of over $100 million each. The retailer-cooperatives which have shown the fastest growth rates are composed largely of supermarkets.

(5) Voluntary groups associated with a grocery wholesaler--at least 11 with retail sales of over $100 million each. Many stores associated with voluntaries are supermarkets, but large numbers are smaller stores.

A final group, which is newest upon the scene, is:

(6) The superette and bantam supermarket chains. These are generally composed of smaller stores with one or two check-out stands and a limited assortment of fast-turnover items, featuring long hours of business (for example, 7 a.m. to 11 p.m.) and convenient locations. A number of chains of this type are already in existence and plans for many others have been announced in different areas of the country. Some supermarket chains also are in this business.

The available data do not tell us all we would like to know about the share of the market held by each of these groups and how it has changed over the years. The general picture is shown in figure 2. As supermarkets grew, the share of specialty food stores (such as meat markets, fruit and vegetable stores, and delicatessens) declined from 17 to 12 percent of total retail store sales of food between 1935 and 1958. Over the same period, country general stores and other stores found their food sales falling from 9 to 2 percent of the national total. These figures cover only sales of food in retail stores, not sales of all items including nonfoods. Figures on total sales would be somewhat different in detail, although the general picture is similar.

Both chains and independents increased their shares of total food sales as specialty food stores and general stores declined in importance. Chains as a group increased their share from 26 to 35 percent between 1935 and 1958. The three national chains held virtually steady at 16 percent of total food sales despite some minor fluctuation from year to year. Regional chains increased sharply in importance as new firms entered the group and older regionals increased their sales. In the midthirties, there were only three regional chains. Today there are at least 20. Local chains increased their share of the market from 1935 to 1954, but their proportion declined between 1954 and 1958 as several of these firms moved into the regional group through mergers.

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The voluntary and cooperative groups have increased sharply in importance, especially during the 1950's. In the midthirties, they had approximately 23 percent of the retail store food business. By 1958, their share had grown to about 37 percent.

The Elements of Competition

Food retailing is nearing the end of the transition from dominance by the small, neighborhood grocery store (whether chain or independent, affiliated or unaffiliated) to dominance by the supermarket. Food marketing now moves into an era when the pace is generally set by the operators of supermarkets, although the bantam supermarkets may well play a significant role in a rather specialized portion of the market.

In the neighborhood store era, the chainstores built their business on the basis of lower prices than those of their independent competitors. Independents were able to gain some of the economies of mass buying of the chainstores by joining the cooperative and voluntary groups which grew up, and through a lowering of wholesalers' margins. However, independent stores were generally not able to match the prices of the chains during that period.

The elements of competitive strategy in the late 1950's are somewhat different, both in kind and in relative importance, from those of earlier years. The degree to which each of these elements is available to each of the major types of firms and the skill with which management applies them will largely determine the structure and performance of the retail food market in the decade ahead. In broad terms, there are six elements of competitive strategy:

(1) The economies of mass buying.

(2) The economies of internal distribution.

(3) The economies of mass selling.

(4) Ease of entry of new firms into food retailing.

(5) Private brands.

(6) Merchandising policies.

Within each of these areas, there is a "scale effect"; in other words, the degree to which a given organization can utilize each of these elements of competitive strategy depends partly upon the size of the organization itself, as well as upon the type of organization.

The economies of mass buying are of two types. First, there are obvious economies to be obtained by buying in carload (or trainload) lots rather than in lots of 10 to 20 cases. This involves reduced costs of physical handling both for seller and buyer and reduced unit costs of buying and selling. Second, there are economies obtained through increased bargaining power on the part of large retailers, the ability to manufacture products themselves, or--perhaps more important--the ever-present unspoken threat to manufacture a

given product rather than buy it from present sources. These economies are almost entirely a matter of scale--the larger the firm, up to some unknown point, the greater the economies of mass buying. Generally speaking, these economies are available to all supermarket operators. The national chains have sufficient buying power to enjoy them in their own right. Regional and local chains can achieve a quite similar position through joint buying organizations formed by the chains. Independent supermarkets and small local chains can join cooperative or voluntary groups, which in turn may be affiliated with national organizations that buy for the member groups.

The economies of internal distribution (wholesale handling) are largely a function of the size of the warehouse unit; that is, the volume of merchandise handled through the wholesale warehouse. Thus, the national chains with from 20 to 40 warehouse units each probably do not obtain significantly lower warehouse costs (including distribution to retail stores) than do large local chains or cooperative or voluntary groups with similar volume per warehouse. Approximately equal levels of warehousing and distribution costs are available to almost every supermarket operator.

The economies of mass distribution at the retail level--lowering of costs by spreading the overhead and operating costs of the retail store over a large sales volume with rapid turnover--are almost entirely a function of the size of the individual retail store. In short, every supermarket of a given size has essentially equal opportunities to reduce the costs of retail store operation.

The question of ease of entry of new firms into food retailing and its importance is widely debated in the retail food industry. Individual store sites have become important competitive factors. Shopping centers have become targets for the location of supermarkets. In turn, the reputation and "drawing power" of the supermarket firm have become significant factors in the success of the shopping centers. Generally speaking, chains which are important in the local market--whether they are national, regional, or local--and which have a large enough number of stores to spread the risk are more highly regarded by developers and financers of shopping centers as "drawing cards" than are the independent stores. Several chains have embarked on shopping center development programs of their own in order to control entry into strategic locations. By this means, they can prevent the location of more than one supermarket in a shopping center, as often happens, with the result of splitting the business and raising the costs for all concerned.

Ease of entry is also closely related to the availability of financing. The large chain generally has a wide variety of sources of credit, including retained earnings, sale of securities to the public, and many types of financial institutions. Many cooperative and voluntary groups have developed financing programs of their own which make these sources of credit available to potential operators of independent supermarkets. While sources of credit such as these may not entirely equalize opportunities for financing, they have certainly narrowed the gap materially.

Private brands under the retailer's or wholesaler's own label (as contrasted with the manufacturer's brands) are a competitive tool on both the buying and selling side. Generally speaking, the retailer can obtain

private-label merchandise to his own specifications at somewhat lower prices than he pays for comparable nationally advertised brands. There are two reasons: First, the manufacturer does not have the expenses involved in advertising and promoting his own brands; second, the bargaining power which the retailer possesses, just because the label is his own, enables him to buy his private-label merchandise from many different manufacturers, or he can manufacture it himself.

On the selling side, private brands furnish a merchandising tool. The operator may use them in different ways. Because he purchases private-label goods at a somewhat lower price than national-brand goods, he has the possibility of using them either as a promotional device or a margin-builder. If he chooses to use private brands as a promotional device, he will set a relatively low margin on the goods and use the resulting lower retail prices as a means of attracting business. Alternatively, he may choose to maintain the retail prices of private-label items close to those of national brands, gaining better-than-average margins on these commodities and using other means to attract business. Private brands may be a means of attracting business, in some cases, through superior quality.

The availability of private brands to the individual retailer is chiefly a matter of buying power. If the firm is large enough, either alone or in combination, to obtain the economies of mass buying, it can also obtain private-label merchandise at competitive price levels.

The elements of merchandising policy, in addition to the use of private brands, are infinitely varied. An important element is advertising. Although other means are used by some operators with some success, generally speaking the basic method of communication with potential customers is through the daily newspapers. Volume of sales within the local market is the basic determinant of the cost of advertising per dollar of sales (that is, the cost of a week's newspaper advertising divided by the firm's sales within that market), and thus of the usefulness of newspaper advertising to the firm. The firm with only one or a few stores in the market is at a decided disadvantage. Substantial local chains are about on a par with regional and national chains in advertising, but voluntary and cooperative groups operate at some disadvantage because of the necessity of agreeing on the items to be advertised and of setting uniform prices for all members of the group. Successful programs by some affiliated groups indicate that such cooperation is possible, but it requires a closely knit group of supermarkets with similar overall merchandising policies to make it so. In a number of cases, the sponsors of voluntary and cooperative groups have established separate groups, using different store names, in order to achieve this end.

The wide variety of goods available in today's supermarket is itself an element of competitive strategy. The potential shopper is attracted by the prospect of choosing from among 5, 6, or 7 thousand items. Management must balance the drawing power of wider variety against the lower rates of turnover to be obtained with additional commodities, since the fast-moving items are already in the store. All types of firms are on an essentially equal footing as to the availability of any item they choose to stock. The limiting factors are the amount of shelf space available to hold the items chosen and the availability of capital to finance the additional stock.

The perishable commodities (meat and fruits and vegetables) play an important part in competitive strategy, serving as "traffic builders." Shoppers quite generally appear to consider that dry groceries and household supplies will be available in all supermarkets at similar if not exactly equal prices--with some differences because of the availability and relative price levels of private brands--and, therefore, their decisions as to which store to patronize can be strongly influenced by their impressions of the quality and price levels of the perishables. For perishables, quality considerations are relatively more important than for other commodities, which are generally assumed to be approximately equal in quality. The "store image" in the mind of the shopper--the shopper's overall impression of the store and the class of customer patronizing it--appears to be influenced more by the quality and price of perishables than by any other factor. 2/

In meats, the use of U. S. grades for beef puts retailers of all sizes and types on substantially equal footing in promotion (and in purchasing, except for advantages derived from volume buying), and has effectively offset the market power of the national meatpackers' brands. 3/ Broilers have been almost universally used as a traffic builder, and have been featured, at prices which represent very low margins, by all types and sizes of retailers.

Fresh fruits and vegetables also are in the front rank of traffic builders, as attested by the location of the produce department in many supermarkets as the first department which the shopper enters. Freshness and appearance are the most important elements in building a quality reputation for the produce department. With almost no brands or grades at the retail level, fruits and vegetables are bought almost universally by inspection.

These elements of competitive strategy are utilized differently by each firm. They are combined in different ways so that each can make a somewhat unique appeal to the potential shopper, in an attempt to attract a group of regular customers who will return week after week. Some stores make their strongest appeal to shoppers seeking economy--they try to offer the lowest general price level within the group of supermarkets available in a given market. Others make their appeal more on the basis of high quality--they offer the best merchandise available, even though at somewhat higher prices. Still others emphasize wide assortments of items, with gigantic stores, a maximum number of brands of each item, and extensive specialty-food departments.

All types of supermarkets are on substantially equal footing in the availability of these varied competitive strategies, or at least they can become so through affiliation with one type of organization or another. Thus, the examination of chainstore policies and practices in fresh fruit and vegetable procurement, to which the remainder of this report is devoted, tells us a great deal not only about the important share of the market which they control directly, but also about the retail store market as a whole. This is not the entire food market, of course, since the institutional segment--all types of away-from-home eating places--accounts for 15 to 20 percent of the total. But that segment will not be dealt with here.

2/ Food Business, p. 37. December 1959.

3/ Williams, Willard F., Bowen, Earl K., and Genovese, Frank D., Economic Effects of U. S. Grades for Beef, Agr. Mktg. Serv., Mktg. Res. Rpt. 298. January 1959.

THE CONSUMER MARKET FOR FRESH FRUITS AND VEGETABLES

If an analysis of procurement policies and practices of chainstores is to have meaning, it is necessary to consider the characteristics of the market in which sales are made. In all the regional and national chains interviewed except two, the buying and selling of fresh fruits and vegetables were coordinated under the control of a merchandiser. The idea is that these two functions are indivisible. The buyer purchases with the consumer in mind. The seller prices, advertises, displays, and features the items with a view to moving what has been purchased.

Chainstore merchandisers know that consumers have certain definite preferences. But they also have a healthy respect for their own ability to convince consumers that they want what the merchandisers want to sell them.

In the following sections, the analysis of the characteristics of consumer wants and preferences is based largely upon evaluations by the chainstore merchandisers and buyers interviewed. This is the market as they see it, the market to which they address their advertising and promotions, the market for which they buy their produce. It is also the market which they, together with growers and marketers of fruits and vegetables, helped to mold in its present form.

Characteristics of Consumer Demand for Fresh Fruits and Vegetables

All the produce buyers interviewed agreed that in fresh fruits and vegetables, quality is the first consideration, and price is somewhat secondary. The characteristics which appeal to consumers are freshness, color, size and uniformity of size, and absence of defects. It is these characteristics which procurement policies are designed to obtain at prices that are in line with competition.

Shifts in consumption have made it more difficult for the procurement officers to meet these consumer requirements on specific items. There has been a movement away from the "hardware" items, such as potatoes, onions, citrus fruits, and apples, in favor of the soft fruits and "wet vegetables," such as peaches, pears, lettuce, and tomatoes. In recent years, partly as a result of the inroads of frozen vegetables, there has been a further movement away from the cooking vegetables in favor of salad vegetables. 4/ The items which are becoming more popular are more subject to spoilage and diseases than are those which they partially replaced. They are also items where freshness, absence of physical defects, and flavor are the most important considerations.

There is a general belief among chainstore produce merchandisers that the consumption of salad vegetables will continue to rise. As incomes increase, knowledge of nutrition spreads, and the desire to control weight intensifies, fresh salads are expected to become a more popular item in menus.

4/ Manchester, Alden C., and Podany, Joseph C., Shifts in Supply Areas and Consumption Rates for Vegetables, 1939-1955, Agr. Mktg. Serv., Mktg. Res. Rpt. 221. March 1958.

Another characteristic of the market for fresh fruits and vegetables is the demand for a greater variety of commodities throughout the year. Probably one of the main causes of the shift from "hardware" items has been the greater availability of a variety of produce during the different seasons at relatively lower prices than formerly. Sweet corn, for example, was available before World War II only during a few months in the summer. Now it is available 12 months of the year at prices which make it competitive with other fresh vegetables. The total supply of vegetables in the winter and spring is now relatively greater than it was 20 years ago. 5/

The fresh fruit and vegetable merchandisers interviewed were generally agreed that there was a high elasticity of substitution between one fresh fruit or vegetable item and many others. Substitution readily occurs, they assert, if either price or quality is not "right." They were not agreed, however, on the extent to which frozen fruits and vegetables would be substituted for fresh items. The view expressed by most of the respondents was that the frozen products had already made what inroads they were going to make into the fresh market, and that these were largely confined to vegetables for cooking and to fruit juice concentrates. Generally, consumers do not substitute frozen products for any of the salad vegetables or table fruits for fresh consumption, although there is some evidence that a major change in availability and prices of winter vegetables, such as occurred during the 1958 Florida freeze, did bring about such substitutions in some areas of the country.

MERCHANDISING PRACTICES

Merchandisers say that they can sell two or three times as much of a particular item in a given week if they place it advantageously in the store and feature it in mass displays. The response of buyers to mass displays and promotions gives the fresh fruit and vegetable merchandiser considerable leeway in the selection of the commodities he wants to promote. This does not mean, of course, that sales of all or even a substantial share of the items in the produce department could be doubled simultaneously by these means.

The chain knows that it cannot guarantee its customers produce of the same quality from year to year or from season to season within the year. In some years, a given item of produce from a given area will be inferior to what the customers usually expect. If these items are featured by the store, its customers will be disappointed when they purchase them. On the other hand, it must stock these items regardless of how poor the quality is that season, in order to offer the complete selections its customers have come to expect. To minimize this problem, the stores usually keep their poorer quality items in less prominent displays and give them little or no promotion. In the meantime, their buyers are seeking out the better quality items that are in more abundant supply, which will be placed in mass displays and promoted vigorously. By this means, the chain organization can induce consumers to buy the good-quality items at reasonable prices as a substitute for the less desirable ones; at the same time, the store is not put in the position of encouraging its customers to buy inferior merchandise.

5/ Manchester and Podany, table 2; see footnote 4, p. 14.

It may be that the large chains have a fairly important advantage in having their own buyers in the field who can keep them better posted on the forthcoming supplies and qualities. They are in a better position to "shop around" among shippers to locate the quality of merchandise which they want than is a smaller chain which buys from a small group of regular shippers.

All chains have backroom coolers and refrigerated display space in most stores. They all have separate produce managers or produce department heads in each store. Most chains provide some form of special training for their produce men to teach them proper care, preparation, and display methods. In some cases, formal training courses are held. A number of chains have produce supervisors for groups of 5 to 15 stores, who work with the store produce managers.

Pricing of merchandise is still an important factor in sales promotion. Buyers always mentioned the fact that, no matter how experienced they are, they occasionally become overstocked. They must price to move the merchandise at all times. Some chains send out price bulletins to their stores two or three times a week. Some instruct store managers or produce department heads to reduce prices on lower quality items to move them rapidly.

Different chains utilize prepackaging of produce in different ways. A few prepackage every item in the produce department, at least to the extent of price marking it as in the case of watermelons and cantaloups. Several others have experimented with 100 percent prepackaging in several test stores, found that it was not successful for them, and shifted to offering consumers a choice between prepackaged and bulk displays on many items. Other chains put their main emphasis on bulk displays, with prepackaging confined to a few items such as potatoes, onions, carrots, grapefruit, and perhaps some apples.

To some extent, the emphasis on prepackaging varies from one market to another. In Los Angeles, surrounded by fruit and vegetable growing areas, prepackaging has not taken hold and no chain prepackages more than perhaps 20 percent of the items in the produce department. Other markets in the West also deemphasize prepackaging. On the other hand, some chains in eastern markets--and at least one in Florida--have gone to 100 percent prepackaging. The average in many eastern and midwestern markets is probably 60 percent. Chains which operate in more than one market have adapted themselves to local preferences, prepackaging heavily in one market and much less in another.

Chains which deemphasize prepackaging argue that "the reputation of the store is in each bag." The customer will not blame the store if she picks out the produce herself and finds some of the items in poor condition. When she takes home a bag of prepackaged produce, however, she blames the store if it is not up to her standards in every way. With prepackaging occurring closer to the source, the distance and time from the prepackaging to the consumer is greater and there are more chances of spoilage.

Most buyers feel that prepackaging should be done as close to the source as possible, particularly for "hardware" items. Many chains do the prepackaging at the central warehouse for the district--two doing it all there. Others are shifting to buying more at shipping points or from prepackaging

firms in the terminal markets. Several who previously prepackaged at the warehouse level are buying all from outside firms.

The economies of prepackaging at the source include utilization of cheaper labor in areas where space is less costly, and savings in freight by not shipping across the country merchandise that is not salable. An advantage of the terminal market in prepackaging lies in the ability to get a better quality to the consumer by removing off-quality items closer to the point of final sale.

A shift toward more prepackaging at the shipping point tends to make for tighter grading at that point. The product that the consumer gets is determined farther back in the marketing channel, requiring much more careful selection and grading of the commodity at the shipping point.

PROCUREMENT POLICIES AND PRACTICES OF SUPERMARKET CHAINS

The preceding section analyzed the characteristics of consumer demand as seen by the merchandisers and buyers interviewed, and described merchandising practices of supermarket chains. However, the procurement policies in which this report is primarily interested are, in fact, governed in part by the consumer market which is to be supplied, and by the promotional methods used in influencing it. It is only through the knowledge of the one that the other can be understood.

Buying Organizations of Chainstores

The buying organizations of chainstores vary considerably. Every available marketing agent and channel are used by some of them all of the time and by all of them some of the time. The surprising feature is not that they vary, but that there is a consistency in the direction in which they are moving. The differences that exist seem to be determined for the most part by the size of the organization itself, which prevents some of them from employing certain features of the organization of larger firms.

National Chains

The three national chains have broadly similar buying organizations. Each has field buyers who cover as many of the important producing areas as possible. They select the merchandise and negotiate the prices. The orders for merchandise originate with the branch offices of the chains and, in some cases, are relayed to the national buying departments. The buying departments then instruct the buyers what commodities to buy and the quantities to buy. In other cases, the regional offices order directly from the field buying offices.

In the case of a special promotion, the flow of information is somewhat different. When large quantities of merchandise are to be purchased and moved, the national office may suggest the promotion and secure the cooperation of the various divisions or branches in following through. This seems to be one of the advantages in having field buyers. They can keep the

national office informed of the production and movement of the merchandise so that promotional activities can be planned in advance.

The large national organizations have their own packing sheds in a few areas, and also sheds for commodities where the volume is large, such as potatoes. One national chain does substantially more of its own packing than the others. A second is generally moving out of the packing business on the ground that it does not pay, and the other does little or none of its own packing.

All of the large organizations buy in the terminal markets on occasion. Some have their own buyers at the markets. Terminal market purchases provide fill-ins when, as often happens, planning is less than perfect and additional quantities are needed to meet the requirements of the stores for the next few days. Specialty items which are not needed in carlot quantities also are purchased at terminal markets or at the fruit auctions, particularly at the beginning or end of the season for a particular commodity when prices are high and the quantities needed are small. Replacement purchases are made in the terminal markets when merchandise bought direct from the shipping point turns out, on arrival, not to meet the quality specifications. And some terminal purchases are made simply because prices in the local market are temporarily low relative to those at the shipping point.

In addition to the field buying organizations, all of the national chains buy, on occasion, either through brokers or directly from shippers, produce which has not been inspected by their own buyers. In these cases, they may try to buy on arrival-guaranteed basis, the price being determined f.o.b. but the shipper assuming responsibility for the quality on arrival. One of the national chains tries to buy all of its produce on a quality-guaranteed basis.

All of the large organizations indicate that the trend is toward direct buying. Even the fill-ins are becoming less, they say. Trucks can be loaded in the South and delivered to most places in the North in a couple of days. The large organizations express the view that the terminal markets create an element of instability in both price and quality. The bypassing of these markets will, they feel, take some of the speculation out of the fruit and vegetable market and give more scope for merchandising.

One of the large chains is decentralized to the point where the branch or regional office has authority to buy its produce in any amount it desires from any source it chooses, either at the shipping point or the terminal market, without reference to the national buying organization.

Regional Chains

The procurement methods of the regional chains vary from those of the national chains only in degree. Their purchases are not as large as those of the national chains; consequently, they cannot afford to cover the growing areas as completely with their own fieldmen. All of the regional organizations have their own carlot buying operations. The carlot buyers at the chain headquarters keep in daily contact with the growing areas by telephone, buying

direct from shippers and, on occasion, through brokers. They select the growers with whom they deal on the basis of experience and occasional trips to the major production areas to become better acquainted with the shippers and their operations.

In addition to the carlot buying operations, some of the regional chains use field buyers. Unlike the national chains, they have only a few permanent buying offices located in the most important producing areas and, in some cases, buyers who follow the harvests up and down the East Coast and into the Middle West. All of these firms also buy in the terminal markets from receivers, prepackagers, and the fruit auctions. Several of the regional chains have moved heavily into direct buying during the later 1950's. At least two of them did so by buying out a receiver which had previously been a major supplier.

Most of these regional chains have had special buying programs with local growers for a number of years. In every case where local growers supplied these firms, they did so on a more or less permanent basis. Considerable effort went into the education of the growers as to the quality, size, and degree of maturity wanted by the chainstores. The chain organizations were proud of the fact that they maintained their suppliers year after year and that the number was constantly growing.

Some of the chains indicated, on the other hand, that local produce was a problem. It was frequently not of good quality, nor well graded, and losses from spoilage were high. One chain stated that the big problem with local produce was in dealing with many small farmers. However, most of the firms felt that the local produce was important in attracting customers. In almost all cases where local produce was handled, the farmers delivered it directly to the chainstore warehouse.

Local Chains

All of the limited number of local chains interviewed were buying direct, in different degrees and by various methods. One had a field buyer who followed the harvest. The others relied more on brokers and a limited amount of direct purchase over the telephone from a small group of regular shippers. Another obtained its produce through a buying company which it owned jointly with another chain. Still another had no produce warehouse, loading the trucks for delivery to the stores directly out of the railway cars and routing at least some of the over-the-road trucks directly to the stores. This chain bought through brokers, and some quantities direct from shippers, with liberal fill-ins on the local market. It felt that, by maintaining good relations with its shippers over the years, it could buy as effectively as the large chains.

In general, the buying methods of local chains were similar to those of the regional chains except that, being generally somewhat smaller, they found it necessary to buy somewhat larger proportions of their merchandise on the local markets, and their distant purchases were more often made through brokers.

Quality Specifications

Almost universally, chainstore buyers stated that they were always attempting to secure high-quality produce, but qualities which were realistic--that is, qualities which were available in large volume at prices which would be competitive. Thus, each organization was always striving for the best quality obtainable at the price level which it had set for itself in relation to its competitors. In every case, this was somewhat above the minimum requirements for U. S. 1 grade.

Most chains do not write detailed quality specifications for fresh fruits and vegetables. Their produce manuals are educational material, not buying specifications. They rely on general quality terms, rather than highly specific descriptions, to convey to the seller the quality which they want, except for size specifications on items such as potatoes and apples. Of course, in the long view, they are relying on the educational effect of experience to convey to the seller the desired information--if the produce does not measure up to their quality standards, the fact will be called to the shipper's attention by rejection of the load or by other means.

Chains with their own field buyers, of course, have an advantage in dealing directly with shippers--they often can see the merchandise they are buying and decide for themselves whether or not it meets their standards. Other chains must rely on educating their buying brokers or shippers to the qualities they desire.

IMPLICATIONS

Clearly, a study such as this raises many more questions than it can answer. Further research is under way in the Agricultural Marketing Service, exploring many of the facets of the problem which are touched upon only briefly in this exploratory study. However, the broad outlines of change are revealed here.

The structure of food retailing has changed markedly during the last 30 years. Small grocery stores and specialty food stores have given way to supermarkets, most of which are organized into groups for procurement and merchandising purposes--either corporate chains or affiliated groups. Substantially similar competitive strategies are available to all such groups, provided they are of a minimum size which makes it possible for them to utilize the varied elements of competition. Larger groups have some advantages through economies of scale in some operations, but these are offset in an unknown degree by problems which arise out of size--the necessity to procure larger quantities and the difficulties of management control, which can be summarized as the problem of flexibility.

Each group strives to create for itself a favorable competitive position, combining the various merchandising policies and practices in somewhat different ways. All utilize fresh fruits and vegetables as a "traffic builder," some attempting to build a reputation for the highest possible quality almost regardless of price, while others lean more toward price appeal and are satisfied with somewhat lower levels of quality. All groups emphasize the gearing

of procurement policies to movement of large volumes of produce with fast turnover and emphasis on freshness. Some have moved toward 100 percent prepackaging with every item in the produce department price-marked and, wherever possible, wrapped. Others emphasize the greater freedom of choice inherent in bulk displays, catering to a group of shoppers who prefer to select their own individual peaches or potatoes. Each endeavors to attract and hold a group of customers to whom its particular set of merchandising policies and practices appeals.

Each group has organized its procurement activities so as to provide its stores with supplies of fresh fruits and vegetables at the quality and price level selected as most suitable for its own competitive strategy. There has been a general movement toward direct buying from the shipping point. The larger chains generally feel that they can purchase at lower average prices by going directly to the grower or shipper and eliminating the cost of handling in the terminal market. Many smaller chains believe that they could probably purchase at similar prices in the terminal markets, but they too are moving to more direct buying in order to obtain assurance of supplies of the desired quality somewhat earlier than would be possible if they bought on the terminal markets. By buying in larger lots--often full carlots or trucklots--directly from shippers whom they know and in whom they have confidence, they feel that they have better assurance of the arrival of the desired quantities and qualities than if they were buying from day to day on local markets. Thus, they are able to plan their advertising and merchandising campaigns on the basis of reasonably assured supplies and qualities at known prices.

The procurement methods and buying organizations of the different groups vary from one to another, but there are broad similarities within the major types. Each of the national chains has an extensive field buying staff, with offices (year-round or seasonal) in all the major producing areas, who are in direct touch with growers and shippers and can buy very largely on the basis of actual inspection. The regional chains are not large enough to maintain field buying organizations as extensive as those of the national chains, but many of them have a few field offices in the most important production areas (for example, in Florida for eastern chains). Their buying in other areas is done both through buying brokers at shipping points and directly over the telephone from growers and shippers. The head office buyers of all groups generally make a practice of visiting the major areas every year or two, to discuss with growers and shippers their problems and the qualities they want and to look over the facilities and methods of the shippers.

Large local chains seldom feel that they can afford field buying offices. They generally buy some items directly over the telephone from a group of selected shippers. In other areas, they use the services of buying brokers, and in still others, they often buy through brokers located in the terminal markets. Smaller local chains rely to a much larger extent upon receivers and auctions in the terminal markets, but many are buying increasing quantities through terminal market brokers; also, a few large-volume items such as potatoes may be purchased directly from one or two shippers.

The buying organizations of voluntary and cooperative groups are generally similar to those of large local chains, with similar variations depending upon the size of the group.

The number of chains--corporate, voluntary, and cooperative--which were large enough to buy direct from shipping points has increased sharply during the postwar years, especially in the 1950's. The importance of direct buying is not in its novelty--the national chains were purchasing at shipping points long before the first supermarket was dreamed of. The change is in the number of chains which are able to buy direct.

The Limits of Direct Buying

Obviously, the controlling factor in the expansion of direct purchasing is the share of the total fruit and vegetable market controlled by chains--corporate, voluntary, and cooperative--which are large enough to buy economically direct from shipping points. To some extent, the decisions of expanding organizations as to when to go into direct buying and how far to go into it will be conditioned by the performance of the terminal markets. If adequate supplies of produce are available at competitive prices on the terminal markets, there will be much less incentive for smaller groups to go into direct buying on a major scale.

While there is no basis upon which to predict the precise nature of the structure of food retailing in the years ahead, a projection of the changes of the past 30 years seems to indicate further growth of buying groups of all types which are big enough to buy directly from the shipping point if they wish to do so. The outside limits of such growth would seem to be set by the needs of at least three groups to buy in terminal markets:

(1) Restaurants, hotels, and institutions.--Very few restaurant chains are large enough to buy direct and the numerous hotels, hospitals, industrial cafeterias, and similar institutions almost universally are too small to buy away from the local markets. The institutional market, which comprises about 15 to 20 percent of the total food market, will probably continue to be served through the terminal-market operators.

(2) Unaffiliated independent grocery stores.--The proportion of such stores has declined steadily for several years, but there is probably a point beyond which it will not go. A floor of 10 percent of total sales does not seem unreasonable.

(3) Chainstores making some local purchases.--Fill-ins, specialty items which are bought in small volume, prepackaged items which the chain does not wish to package itself, and similar local purchases will continue. Typically, such items amount to 20 to 30 percent of the total purchases of such groups, although there are individual instances where the figure is both lower and higher.

On the basis of these estimates, the ceiling on direct buying of fresh fruits and vegetables appears to be somewhere between 50 and 60 percent of total volume. This is not, of course, a prediction that direct purchases will go to such a level. It is merely an indication of the ceiling which seems to exist.

Implications to the Wholesale Market

It seems likely that the share of the total volume handled by receivers, jobbers, service wholesalers, and other terminal-market operators as a group will continue to decline as direct buying by various types of chains increases. The possible limits to this decline have been indicated, and it is quite possible that the decline will not go this far, particularly if smaller chains find that they can obtain supplies on the local markets which are competitive in quality and price with those which other firms are purchasing directly from the shipping point.

The actual volume probably will not decline as rapidly as the share of total volume, due to increases in population and total consumption in the years ahead.

The traditional function of wholesale distribution--purchasing large lots and breaking them down into smaller lots for sale to retailers and secondary wholesalers--probably will become less and less important. Many terminal-market operators will need to become specialists in one or more functions. For example, the role of the service wholesaler as the supplier of unaffiliated independents and small groups is already clear and offers an opportunity for some additional operators in many areas. There is also a place for a fairly limited number of specialized prepackagers who can supply to chains, service wholesalers, and others items which cannot be economically prepackaged at the shipping point. The institutional market probably will continue to be supplied largely by purveyors.

Implications to Producers, Packers, and Shippers

As the size of retail operations increases and a larger proportion is bought directly from the shipping point, there will be an increased demand for a more uniform product. The size of the lot purchased by an individual organization will increase, on the average. It will be increasingly difficult to dispose of variable lots, small lots, and lots of odd size, grade, color, and other characteristics. This seems to indicate an increasing emphasis on large packing and shipping operations--each one large enough to put up uniform lots which will meet the specifications of some part of the chainstore market. The packer or shipper whose volume is small or whose quality and pack are variable will find it increasingly difficult to dispose of his product at profitable prices.

Markets may tend to become more segmented. In other words, as more buyers begin to buy direct, the first step for many will be to locate a small number of shippers in each area with whom they can reach an understanding on quality, and to buy most of their requirements from these shippers. Thus, shippers will tend to become identified with a relatively small number of buyers, and vice versa. While this will simplify the problem of "finding a market," it will tend to divide the total market for a given commodity into many submarkets which are less closely connected.

Volume control will become more important. As the "marginal market"--the market for supplies which cannot be sold to direct buyers--shrinks, the effect

of each additional carload added to or withdrawn from this market will become more pronounced. Wide swings in supply may cause wider swings in price than formerly. It will be increasingly difficult to "clean up" supplies in a market because the number of buyers will have declined.

Implications for the Pricing System

The interest of chainstores is heavily weighted on the side of price stability. Many chainstore produce executives expressed a strong preference for short-run price stability. If they could ignore the possibility of short-run price variations, they would be in a much more secure position relative to their competitors--having an assurance that each one would have approximately equal paying prices--and they could then devote themselves to merchandising efforts.

It is apparent that the increase in direct buying from the shipping point, which bypasses the terminal markets, shifts the emphasis in price determination toward the shipping point. A smaller proportion of the total is actually being priced at the terminal market. However, it would be easy to over-emphasize the importance of this shift. To a considerable extent, the "marginal market," which has a strong influence on price, remains in the major terminal markets. A car which cannot be sold at the shipping point is still rolled to market and assigned to a broker or commission merchant to sell. A buyer must be found for it, if possible, and the price will be set in the terminal market. There will continue to be a complex set of price relationships among shipping points and terminals, which may well be altered somewhat by a shift to more direct buying but in which both shipping point and terminal will continue to play an important role.

The effects of an individual buyer upon price become more important as he grows in size. Regardless of the intentions of a buyer, his activities are more important if he is one of 100 buyers in a market than they are if he is one of 1,000. One of the national chains cannot avoid having a marked effect upon a given market by the purchasing decisions which it makes from day to day, since its purchases could easily account for 5 to 10 percent of the total and, on individual days, for much more. A large local chain can have an equally marked effect on a nearby market. Size alone changes the impact on prices, no matter how little the individual firm may wish to affect them.

Under these circumstances, the pricing process is already changing and will probably change more. The decision of a few buyers to buy or not to buy, or to buy lightly or heavily, can have a marked effect upon prices. If there were no other changes in the price-making system, this would result in more variable prices, since changes in demand from day to day would be in larger units. Of course, other changes in marketing institutions (for example, group bargaining and selling) might well overcome the effects of this change.

Thus, it becomes apparent that the growth of large buying units works against the price stability which these buying groups themselves would like to see. Further changes in marketing institutions, of a type which we cannot yet foresee, will be needed to create more stable prices.

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